COMMONWEALTH OF PENNSYLVANIA)
)
COUNTY OF MONTGOMERY)

AFFIDAVIT

I, Frank X. Simpson, first being duly sworn upon oath depose and say that I am employed by Consumers Water Company, as Vice President – Rates; that I have read the attached and foregoing Rebuttal Testimony of Frank X. Simpson in Docket Nos. 00-0337, 00-0338 and 00-0339 (consolidated), which is identified as CIWC Exhibit 6.0R as well as CIWC Exhibits 6.01R, through 6.05R, which are attached thereto; that these documents were prepared by me or under my supervision and I know the contents thereof; that said contents are true in substance and in fact; and that CIWC Exhibits 6.0R through 6.05R are the testimony and exhibits I wish to give in this proceeding.

Further affiant sayeth not.

Frank X Simpson

Frank X. Simpson

OFFICIAL FILE
I.C.C. DOCKET NO. 00-0337-0339
CIWC Exhibit No. 6.0R-6.05R
Witness Simpson
Date 11/17 Reporter [illegible]

Subscribed and Sworn
to before me this
13th day of November, 2000.

Mary C OKeefe
Notary Public

DOCS1:47213.1 11/13/00 1:52 PM

Notarial Seal
Mary C. O'keefe, Notary Public
Lower Merion Twp., Montgomery County
My Commission Expires May 17, 2004
Member, Pennsylvania Association of Notaries

\\OFF_1\VOL2\SHARED\FINGRP\RATE\Rate 2000 Illinois\Surrebuttal\affidavitsSIMPSONRebuttal.doc

CIWC EXHIBIT NO. 6.0R

BEFORE THE ILLINOIS COMMERCE COMMISSION

REBUTTAL TESTIMONY

Of

FRANK X. SIMPSON

ON BEHALF OF

CONSUMERS ILLINOIS WATER COMPANY

DOCKET NOS. 00-0337, 00-0338, 00-0339

Consolidated

September 29, 2000

WITNESS IDENTIFICATION AND BACKGROUND

Q. Please state your name and business address.

A. Frank X. Simpson, 762 Lancaster Avenue, Bryn Mawr, Pennsylvania.

Q. Have you previously submitted testimony in this proceeding?

A. Yes. I sponsored CIWC Exhibit 6.0 and certain of the A, B, C, D and H Schedules of the Standard Information Requirements set forth in CIWC Exhibits 11.0, 12.0 and 13.0 for the Kankakee, Vermilion and Woodhaven Water Divisions, respectively.

Q. What is the purpose of your rebuttal testimony?

A. The purpose of my rebuttal testimony is to respond to specific portions of the direct testimony presented by Staff of the Illinois Commerce Commission. I will respond to ICC Staff Exhibit 1.00 (Dianna L. Hathhorn), ICC Staff Exhibit 2.00 (Steven R. Knepler), ICC Staff Exhibit 3.00 (Mike Luth), ICC Staff Exhibit 5.00 (Raymond E. Pilapil), ICC Staff Exhibit 6.00 (Roy A. King), and ICC Staff Exhibit 7.00 (Michael G. McNally).

RESPONSE TO STAFF TESTIMONY

Q. Please outline the areas of Staff testimony to which you will respond.

A. I will respond to adjustments in the following areas:

I. Interest Synchronization – Schedules 1.06K, 1.06V and 1.06W

II. Capital Structure -

III. Working Capital – Schedules 1.08K, 1.08V and 1.08W

IV. Depreciation – Schedules 1.09K, 1.09V and 1.09W

V. Deferred Taxes – Schedules 1.10K, 1.10V and 1.10W

VI. Materials & Supplies – Schedules 1.11K, 1.11V and 1.11W

VII. Kankakee Add-On Tax

VIII. Recommendations #2 and 3

IX. Incentive Compensation – Schedules 2.01K, 2.01V and 2.01W

X. Political and/or Lobbying Expense – Schedules 2.01K, 2.01V and 2.01W

XI. Rate Case Expense/Amortization – Schedules 2.03K, 2.03V and 2.03W

XII. Insurance Expense – Schedules 2.05K, 2.05V and 2.05W

XIII. Corporate Office and Vermilion Remittance Center Allocation Schedules 3.01K, 3.01V and 3.01W

XIV. Service Company Billings – Schedules 3.03K, 3.03V and 3.03W

<u>**Interest Synchronization**</u>

Q. Please explain your understanding of Ms. Hathhorn's proposed interest synchronization adjustment for all three Divisions in this proceeding.

A. Ms. Hathhorn has calculated interest expense for income tax purposes by multiplying the Company's weighted cost of debt by its rate base. She utilized the capital structure proposed by Staff Witness McNally in ICC Staff Exhibit 7.00 as the basis of her calculation.

Q. Did the Company compute interest expense using interest synchronization?

A. Yes.

Q. Do you agree with Ms. Hathhorn's interest synchronization calculation?

A. Yes. However, I do not agree with the capital structure and the weighted cost of debt used by Staff. In other words, I agree with the methodology that she used but I don't agree with the application of the methodology, nor the result of her calculations. If the Company and Ms. Hathhorn used the same capital structure and rate base, I believe our interest expense would be the same.

Capital Structure

Q. Do you agree with Mr. McNally's capital structure proposed in ICC Staff Exhibit 7.00 for all three divisions?

A. No, I do not. Mr. McNally failed to recognize the $3,000,000 equity infusion listed in the Company's response to Data Request MGM 3.07. In this response the Company submitted a revised capital structure to reflect the tax-exempt debt issuance which closed on September 28, 2000. This revised capital structure was to the benefit of our customers and actually lowered the overall rate of return the Company was requesting, however, as a result of the tax-exempt debt issuance the equity and short-term debt components had to be updated as well. Schedule 6.1-R is a copy of the response to Data Request MGM 3.07, which reflects the revised cost of debt and capital structure.

Q. Since the Company's last update of the capital structure has anything occurred that would necessitate an additional change to MGM 3.07?

A. Yes, since our last update the Company has priced the tax exempt issue at 5.4%. Schedule 6.2-R shows the response to MGM 3.07 updated for the lower cost of the new issue.

Working Capital

Q. Do you agree with the Staff's methodology of calculating working capital based on 12.50% of operations & maintenance expense?

A. Yes. The difference between Ms. Hathhorn's adjustment and the Company's is the difference between the Staff and Company operations & maintenance expense utilized in the calculation for the three divisions.

__Depreciation__

Q. Do you agree with Ms. Hathhorn's depreciation expense adjustments shown on ICC Staff Exhibit 1.00, Schedule 1.09?

A. I agree with her adjustment in the amount of $143,868, $114,387 and $14,113 for Kankakee, Vermilion and Woodhaven, respectively to remove corporate depreciation expense from Contractual Services and increase depreciation expense by a like amount. However, I find no evidence to support the use of 3.54% and 3.00% depreciation rates on Data Processing equipment for the Kankakee and Vermilion Divisions, respectively. By use of these arbitrary rates, Staff's Kankakee and Vermilion depreciation expense is $66,109 and $57,291 lower respectively, than those supported by John M. Guastella in CIWC Exhibit 8.1.

Q. What is the basis for Staff's adjustment to the depreciation rates proposed by the Company?

A. Staff Witness Roy King agrees overall with the rates proposed by the Company, but believes that Account 340 "Data processing Equipment" should be broken down into sub-accounts "to be more sensitive to the service life and retirement of computers and software" (ICC Staff Exhibit 6.00, pp. 7-8)

Q. Has the Company responded to Mr. King's Data Request RAK 7.00 which asked that Account 340 be broken down into six sub-accounts with information on the "Date of Purchase," "Original Cost-Test Year" and "Depreciation Reserve – Test Year" provided for each sub-account?

A. Yes. The Company has responded RAK 7.00.

Q. Does the Company agree that the Account 340 sub-accounts should reflect separate rates.

A. Yes, it does. Company Witness John Quastella has provided rebuttal testimony (Exhibit 8.0-R) which supports the Company's sub-account rates.

<u>**Deferred Taxes**</u>

Q. How are Accumulated Deferred Income Taxes affected by Staff's proposed inclusion of the Candlewick Sewer Division ("CWS") to the base to which allocable costs are assigned?

A. Staff has not allocated any portion of Accumulated Deferred Income Taxes to the Candlewick Sewer Division.

Q. Should an allocation of ADIT to Candlewick Sewer have been made?

A. Yes.

Q. Mr. Simpson, would you please elaborate on this subject?

A. As I explain in the "Corporate Office and Vermilion Remittance Center Allocation" section of my Rebuttal Testimony, the Company agrees to the inclusion of Candlewick Sewer for purposes of allocating those rate base and expense items. Since Candlewick Sewer has not been sold as was assumed at the time of the rate filings, it is appropriate that Jurisdictional Allocation Statistics on Schedule WP-A5 page 3 of 3 be updated for Candlewick Sewer customers and plant data. Mr. Luth has correctly added the customers, and as a result the appropriate amount of corporate expenses and plant net of accumulated depreciation has been allocated to Candlewick Sewer. Staff notes in response to Company Data Request No. 1 that Company has not supplied the CWS information necessary to re-calculate the plant allocation factor. Consequently, average 2001 plant for CWS has not been added to WP-A5, page 3, and as a result, the allocation percentages based on Plant as shown on B-9, page 4 of 4 are overstated.

Q. What is the average 2001 plant amount which you propose to include on WP-A5, Page 3 of 3, Column D, Line 16?

A. Candlewick Sewer's average 2001 plant is $8,385,398. This results in updated plant allocation factor percentages for Kankakee, Vermilion and Woodhaven of 31.73%, 35.28% and 2.38%, respectively. The Company's rate models automatically revise each division's unadjusted average future test year ADIT shown on Schedule B-9, page 4 to reflect inclusion of CWS.

Q. Had the ADIT on Mr. Luth's Schedule been appropriately synchronized with his plant, depreciation expense and the depreciation reserve adjustment to reflect the inclusion of Candlewick Sewer, what would the impact on Mr. Luth's adjustment have been?

A. If Mr. Luth had reflected ADIT to account for the inclusion of Candlewick Sewer's plant, ADIT would have decreased for Kankakee by $147,350, Vermilion by $163,807 and Woodhaven by $11,062, thus increasing rate base by a like amount.

<u>Materials & Supplies</u>

Q. Please explain Ms. Hathhorn's proposed materials and supplies adjustment for all three Divisions in this proceeding to rate base.

A. Ms. Hathhorn proposes to reduce the test-year materials and supplies balances in the three Divisions by a perceived amount of accounts payable associated with such balances. She claims that CIWC's shareholders have not incurred any cost when the materials or supplies are purchased on account with a vendor. She believes that it is simply "vendor financing" until it has been paid in full. Her adjustment reduced the rate base balances of Materials and Supplies for the three Divisions by one twelfth (1/12), representing one month.

Q. Do you agree with Ms. Hathhorn's proposed adjustment?

A. No, I do not. Ms. Hathhorn's adjustment fails to recognize that in the first month of the test-year we are increasing accounts payable (debit) and a reducing cash (credit) to properly reflect the payment of materials and supplies for the prior month. If you continue this exercise of debits to accounts payable and credits to cash for the remainder of the test-year, you will find that you have an increase (debit) to accounts payable and a decrease to cash (credit) in every month of the test-year. In response to Company Data Request No. 8, Staff asserts that its Materials and Supplies adjustment is not based upon a cash flow basis. I respectfully disagree, since the foundation of Staff's adjustment is its contention that a portion of Materials and Supplies balance is "vendor financed" as reflected in Accounts Payable. If Accounts Payable is going to be utilized with respect to Materials and Supplies, the entire test year should be considered, not any single month. I would further note that Accounts Payable is not a component of Rate Base. To summarize, I believe the Company's average adjusted test-year Materials & Supplies balance as filed is correct.

Kankakee Add-On Tax Adjustment

Q. Please explain Ms. Hathhorn's proposed Add-On tax adjustment for Kankakee.

A. Ms. Hathhorn has deleted the Kankakee City Franchise Fee from operating expenses, since the fee is a pass through.

Q. Do you agree with her adjustment?

A. Yes. The fee is a pass through, and as long as it is reflected consistently in revenues and expenses the Company is made who

Incentive Compensation

Q. Do you have any comments regarding Mr. Knepler's adjustment to incentive compensation for the three Divisions?

A. While the Company agrees with Mr. Knepler's three-year average to determine incentive compensation in this case, it does not believe that achievement of incentive compensation goals in 1997 is representative of 2000 or 2001 since 1997 was a transitional year in which a new management team was hired.

Political and/or Lobbying

Q. Does the Company agree with Mr. Knepler's assessment that the amounts listed on Schedules 2.02(K), 2.02(V) and 2.02(W) should not be included in the expense base of this proceeding.

A. Yes, the Company is in agreement with the disallowance of the expenses shown on Mr. Knepler's Schedules 2.02(K), 2.02(V) and 2.02(W).

Q. Does the Company agree with Mr. Knepler's claim that the expenses in question were allocated to the three Divisions in this proceeding through the "Contractual Services – Management" charges from CIWC Corporate?

A. Yes. Additionally, please note that the Company will be modifying its rate case model to assure itself that these costs will not be included in "Contractual Services – Management" in future cases.

Rate Case Expense/Amortization

Q. Have you reviewed Mr. Knepler's recommended rate case expense amortization periods for Kankakee, Vermilion and Woodhaven?

A. Yes.

Q. Does the Company agree with his recommended amortization periods?

A. The Company is willing to accept Mr. Knepler's amortization periods of 3 and 4 years for Vermilion and Woodhaven, respectively. However, the Company believes that the appropriate amortization period for Kankakee should be 2.5-years (30-months) which is based on the period of time between the last two rate case Orders. The Company received rate case orders in May, 1996, June 1998 and expects to receive an Order in the current case in March 2001. Thus, the interval between the 1996 and 1998 cases is 25 months and the interval between the 1998 case and the 2001 case is 33 months, or an average of 29 months, or approximately 2.5 years or 30 months.

Q. What amortization period did the Company originally file for in this proceeding for the Kankakee Division?

A. The Company originally filed for an 18 month amortization period, but would now agree that this should be expanded to a 30 month amortization period.

Q. Does the Company agree with Mr. Knepler's disallowance of $81,922 of rate case expense incurred in Docket No. 99-0288?

A. No. Mr. Knepler maintains that the Company was not authorized to defer these expenses in Docket No. 99-0288. However, in Docket No. 99-0288 the Commission agreed with the Company that

> well-accepted accounting practices and the USOA permit the allocation of the remaining portion of such costs to the Company's other Divisions and the deferral of such costs for consideration in the future rate proceedings to which they relate. Accordingly, Staff's arguments regarding the benefits and reasonableness of the Conversion Activity Costs are premature., (Docket No. 99-0288, Order at page 21).

The Company believes that it received authority to defer a portion of the System Conversion Costs allocable to its non-Candlewick Water operations and to request recovery in subsequent rate cases for those operations.

Q. Please describe the Conversion Activities and associated costs incurred in conjunction with the Candlewick Water rate case.

A. To convert to the use of a future test year and the New Filing Requirements, it was necessary for the Company to develop an entirely new set of filing schedules, presented in a different format, and containing substantially more information than the schedules which the Company had been required to file in past rate cases under the standard filing requirements contained in 83 Ill. Admin. Code Part 285 ("Old Filing Requirements"). As a result, the Company was required to develop entirely new computer software models to generate the filing requirement schedules. The model containing the new filing schedules was two to three times as large as the model for the previous single-division filing under the old filing requirements. The Company was also required to prepare testimony and exhibits (including, for example, all of the H Schedules) specifically associated with the use of a future test year. The process of converting to use of the New Filing Requirements and a future test year also caused the Company to incur more cost than it otherwise would have incurred for the preparation of a rate filing using a historical test year and the Old Filing Requirements. As previously indicated, the Conversion Activities benefit all divisions and, therefore, the conversion costs should be appropriately allocated to all divisions, not just Candlewick Water.

Q. Why do you believe recovery of rate case conversion activity costs in the current rate cases is reasonable?

A. The Company allocated $81,922 of rate case System Conversion Activity Costs from the Candlewick Water rate case to the current rate cases. Of the $81,922, $39,206 was allocated to Kankakee, $31,291 to Vermilion and $11,425 to Woodhaven.

In the Candlewick Water rate case the Company incurred significant expense in converting systems and schedules from the old filing requirements to the new filing requirements.

Current rate case expense is $155,130, $133,654 and $51,090 for the Kankakee, Vermilion and Woodhaven Divisions, respectively. In these Divisions previous rate cases rate case expense was $253,532, $229,948 and $21,000. Thus, the current case reflects a total savings for the three Divisions of $164,606. Had the Company not incurred the expense in the Candlewick Water case to develop the rate model, additional time and expense would have been incurred in this case, thereby increasing the costs for the current cases.

Allocation of Insurance Expense Adjustment

Q. Please explain Mr. Luth's proposed adjustment to insurance expense.

A. Mr. Luth has proposed an adjustment to insurance expense for the three Divisions to reflect the inclusion of Candlewick Sewer in the allocation process.

Q. Do you agree with Mr. Luth's proposed adjustment to insurance expense?

A. Yes. I believe the adjustment is reasonable.

Corporate Office and Vermilion Remittance Center Allocation

Q. Please explain Mr. Luth's proposed adjustment to the Corporate Office and Vermilion Remittance Center allocation as presented in ICC Staff Exhibit 3.00, Schedule 3.01.

A. Mr. Luth discovered during the discovery process that the Company had not properly allocated a portion of the Corporate Office and Remittance Center costs to its Candlewick Sewer operation. As a result of this Mr. Luth proposed an adjustment to reduce the allocated Plant-in-Service, Depreciation Expense and the Reserve for

Accumulated Depreciation from the Corporate Office and Vermilion Remittance Center to the three Divisions in this proceeding. The allocation reduction was based on the percentage of Candlewick Sewer customers to the total number of customers of CIWC, which is 3.89%.

Q. Does the Company agree that there should be an adjustment to the allocation of the Corporate Office and Remittance Center charges to reflect the inclusion of Candlewick Sewer in the base number of customers?

A. Yes, it does. The reason Candlewick Sewer was not included in the allocation when this case was filed on April 14, 2000 is because at the time of filing a tentative agreement had been reached to sell the assets of the system. However, subsequent to filing the parties could not reach a final agreement.

Q. Does the Company agree with Mr. Luth's proposed adjustments as presented on Schedule 3.01

A. The Company agrees with Mr. Luth's adjustments to reflect the impact of Candlewick Sewer on the Plant-in-Service, Depreciation Expense, and the Reserve for Accumulated Depreciation allocation of the Corporate Office and Vermilion Remittance Center. The Company disagrees with Mr. Luth in that he did not include the impact of Accumulated Deferred Income Taxes ("ADIT") in his proposed adjustments.

Q. Did the Company supply the necessary information on ADIT applicable to the Corporate Office and Vermilion Remittance Center to Staff?

A. Yes. The Company supplied the ADIT information in its response to Data Request No. ML-3, which is attached as Schedule 6.3-R.

<u>Service Company Billings</u>

Q. Please explain Mr. Luth's proposed adjustment to Service Company Billings as presented in ICC Staff Exhibit 3.00, Schedule 3.03 for the three Divisions.

A. Mr. Luth, as stated on page 7, lines 123 through 130 of his testimony, proposes an adjustment based on two factors, 1) the inclusion of Candlewick Sewer in the base for allocating service company billings; and 2) the exclusion of certain expenses in the test-year based on the review of certain components of service company expenses billed to CIWC in 1999.

Q. Please comment on Mr. Luth's first factor, the inclusion of Candlewick Sewer in the base for allocating service company billings.

A. I agree with Mr. Luth that Candlewick Sewer should be included in the base for allocating service company expenses, and that the Service Company Billings for the three Divisions in this proceeding should be adjusted to reflect such.

Q. How did Mr. Luth adjust for the inclusion of Candlewick Sewer in the allocation base?

A. Mr. Luth reduced the test-year Service Company Billings for Kankakee, Vermilion and Woodhaven by the percentage of Candlewick Sewer customers to the total number of customers of CIWC. This calculation is presented on Schedule 3.03, page 2 of 7, at which he reduces the test-year Service Company Billings by 3.89%.

Q. Do you agree with the 3.89% utilized by Mr. Luth.

A. Yes. I believe the 3.89% is the appropriate percentage.

Q. After reduction of a portion of the Service Company Billings related to Candlewick Sewer, do you agree with Mr. Luth's Service Company Billing adjustment?

A. No, I do not, for two reasons. Mr. Luth needs to align his adjustment with those made to Service Company Billings (account 634) by Ms. Hathhorn and Mr. Knepler in ICC Staff

Exibit 1.00 and 2.00. Second, even if Mr. Luth corrects for eliminating some of the Service Company Billings that Mr. Knepler and Ms. Hathhorn have removed, I disagree with the basis for and the calculation of his adjustment.

Q. Please explain Mr.Knepler and Ms. Hathhorn's adjustments.

A. First, to be consistent with testimony presented by Ms. Hathhorn and Mr. Knepler in ICC Staff Exhibit 1.00 and 2.00, Mr. Luth should reduce his Service Company test-year expense by depreciation expense of $272,186. The depreciation expense of $272,186 represents the adjustment Ms. Hathhorn has proposed in Schedules 1.02K, 1.02V, and 1.02W, page 1 of 2 as follows:

Kankakee	($143,686)
Vermilion	(114,387)
Woodhaven	(14,113)
	($272,186)

Secondly, also for consistency purposes the $19,609 of political and lobbying represents the reduction in Service Company expense proposed by Mr. Knepler in Schedules 2.02K, 2.02V, and 2.02W as follows:

Kankakee	($10,358)
Vermilion	(8,235)
Woodhaven	(1,016)
	($19,609)

To summarize my comments on Mr. Luth's first factor of his adjustment, the inclusion of depreciation expense of $272,186 related to Contractual Services and the political and lobbying component of $19,609 in Mr. Luth's Service Company billing base would double-count the adjustment, since it has already been made elsewhere by Staff in ICC Staff Exhibit 1.00 and 2.00.

Q. If Mr. Luth were to adjust his test-year Service Company expense base by the adjustments already made by Ms. Hathhorn and Mr. Knepler, and his

recommended adjustment to reflect Candlewick Sewer, would you then agree with his adjustment in total?

A. No.

Q. With regard to the second factor of Mr. Luth's adjustment, the disallowance of a portion of Service Company Billings based on the review of certain components of the 1999 billings to CIWC from PSW / PSC, do you agree with his methodology or adjustment?

A. No, I do not. I am not in agreement with his methodology or adjustment.

Q. Please explain how Mr. Luth determined this portion of his proposed Service Company billing adjustment.

A. Based on the review of PSW and PSC billings for 1999 and early 2000, Mr Luth determined a "Payroll Adjustment Factor" of 10.452% and a "Sundry Adjustment Factor" of 17.373% which are depicted on pages 2 and 3 of Schedule 3.03 and supported on pages 4 through 7 of Schedule 3.03. These "Factors" were then applied to total test-year Contractual Services – Management (Account 634) for the three Divisions to determine the disallowed amounts. Based on these "Factors", Mr. Luth has proposed an adjustment to disallow 10.452% and 17.373% of the total Contractual Services – Management account that his sample indicates will be payroll related, and sundry related, respectively. This equates to a $124,901 disallowance for payroll related and a $123,781 disallowance for sundry related.

Q. Has Mr. Luth revised his adjustment factors since filing his testimony?

A. Yes. A result of a response to a Company Data Request, which is attached as Schedule 6.4-R Mr. Luth has revised his "Percentage of Lobbying Employee Payroll to Illinois" to 5.223%, which results in a Payroll Adjustment Factor of 6.171%, rather than

10.452% and he has adjusted his "Lobbying Employee Billings to Illinois" to 9.026% which results in a Sundry Adjustment Factor of 14.499% rather than 17.373%. The effect of this change reduces his disallowance for Payroll-related to $73,746 rather than $124,901 and for Sundry to $103,306 rather than $123,781

A. Do you agree with the basis for Mr. Luth's "Factors" utilized to determine his proposed adjustments to Service Company Billings?

B. No. There are several reasons that I believe Mr. Luth's "Factors" to be an inappropriate method of determining test-year charges:

1) Non-recurring infrastructure system improvement charge activity in 1999
   - Assuming Chris Franklin's 1999 activity will be indicative of his 2001 activity
   - Assuming Chris Franklin's 1999 activity is indicative of all PSW, PSC and CWC employees' 1999, 2000 and 2001 activity.
2) Definition of Merger Costs
3) Non-recurring nature of merger cost activity in 1999.
4) Not adjusting the base to which the "Factors" are applied for the impact of depreciation and political and lobbying expenses already adjusted for in ICC Staff Exhibits 1.00 and 2.00

Q. Please summarize what you believe to be Mr. Luth's methodology for determining the "Percentage of Lobbying Employee Payroll to Illinois" shown on Page 4 of 7 of ICC Staff Exhibit 3.00, Schedule 3.03 page 4 or 7 and the

"Lobbying Employee Billings to Illinois" shown on ICC Staff Exhibit 3.00, Schedule 3.03, Page 5 of 7.

A. Mr. Luth reviewed the services and sundry billings of PSW and PSC for the period May 1999 through April 2000 and then determined a percentage of disallowed for payroll related and sundry related. Over 90% of the payroll disallowance of 10.452% was a result of one employee, Mr. Franklin. Mr. Luth then determined that since most of the labor and sundry related costs of Mr. Franklin were lobbying related for the period reviewed, the same portion of all service and sundry billings, in the test year would like wise be lobbying related.

Q. What are the fallacies in Mr. Luth's adjustment?

A. There are several. As I will discuss below, one cannot assume that because Mr. Franklin spent a certain percentage of his time which was allocated to Illinois in 1999 on lobbying, that all employees who provide services to Illinois will spend the same percentage of their time on lobbying in the test year. Moreover, Mr. Luth has selected a period of time as the basis for his adjustment which is not representative of any other period in terms of lobbying related charges to Illinois. His base year contains charges related to time spent on infrastructure surcharge legislation and merger costs, neither of which occur in a typical year.

Q. Why do you think the expenditures related to the infrastructure improvement charge legislation in 1999 should not be used as the basis for disallowing test year service company expenses?

A. During 1999 Chris Franklin, Vice President Corporate and Public Affairs worked with Mr. Brian Duffy to make available infrastructure replacement legislation which had been enacted in Pennsylvania in 1997. Mr. Franklin was not working in a vacuum, he had the support of CIWC and was working directly with the Illinois Commerce Commission's legislative liaison on the benefits of an infrastructure replacement program for Illinois. Mr. Franklin spent the time needed to properly communicate the benefits of an infrastructure replacement program to the Illinois Legislature, and it was most efficient face-to-face. CIWC does not anticipate Mr. Franklin spending any time on infrastructure replacement related activity in Illinois 2001, and is not aware of any special Illinois initiative that might require his time in 2001. The Company does not believe that the year 2001 adjustment should be based on the non-recurring activities of Mr. Franklin in 1999 related to infrastructure replacement legislation. Mr. Franklin's time and sundry billings for 2001 will not replicate his 1999 activity, and to base his time and sundry billing for 2001 on 1999 is not appropriate.

Furthermore, to base all CWC, PSC and PSW employees' time and sundry billings for 2001 on Mr. Franklin's 1999 activity is not appropriate. A portion of Mr. Franklin's job is to monitor legislative activity and its impact on the water utility industry and it would be fair to estimate that a portion of his 2001 time and sundry billing might be for such. However, to assume that an accounts payable clerk or an accountant from Bryn Mawr will be lobbying the Illinois Legislature in 2001 in not realistic. In fact, for purposes of his adjustment Mr. Luth has assumed that every employee who charges time to Consumers Illinois in 2001 will spend as much time on lobbying as Mr. Franklin did in 1999. Such an assumption is unreasonable and not based on fact.

Q. **Is CIWC requesting the recovery of merger costs related to, and detailed in, Docket No. 98-0602?**

A. No.

Q. Did CIWC request recovery of the merger costs detailed in Docket No. 98-0602?

A. Yes. On page 6 of the Commission Order in Docket No. 98-0602 the Company's position was stated as follows:

> In accordance with this provision, the Joint Applicants provided detailed information regarding the cost of accomplishing the reorganization and proposed in their Application that Consumers Illinois be allowed to recover its pro rata share of those costs to the extent that such costs give rise to demonstrated savings in operating expense reflected in test year data in a rate case.

Q. Did the Commission allow for the recovery of merger costs?

A. No. On page 7 on the Order for Docket No. 98-0602 the Commission's position was stated as follows:

> The Commission finds that Consumers Illinois will not be allowed to recover the costs incurred in accomplishing the proposed merger in rates or other charges and that, in future rate cases, all merger-related savings reflected in test year data will be allocated to customers for ratemaking purposes.

Q. Were the merger-related costs documented and presented as evidence in Docket No. 98-0602?

A. Yes. The Company presented its estimate of the merger related costs, which were divided between "Transaction Costs" and "System Integration Costs" and totaled approximately $8,000,000, of which $884,823 was allocated to CIWC. A copy of schedule filed as part of the merger case discussed in Docket No. 98-0602 is attached as Schedule 6.5-R.

Q. Will the Commissions decision of not allowing CIWC the opportunity to recover merger-related costs while at the same time flowing through the merger related savings impact the Company financially?

A. Yes. The Company has incurred approximately $900,000 of expense that it will not be allowed to recover in the rate process; this will make it very hard for the Company to earn its allowed return, when such a component is not included in the cost of service.

Q. **Do you agree with Mr. Luth's interpretation of merger costs which he is proposing to disallow as shown on ICC Staff Exhibit 3.00, Schedule 3.03, Page 4?**

A. No. I think Mr. Luth's definition of merger costs is expanded well beyond that discussed in Docket No. 98-0602. The merger between PSC and CWC was announced in June 1998 and closed in March 1999. In the interim period between announcing the merger and the closing, the integration process of bringing the two companies together had to start. To not address how the two separate accounting systems, customer information systems, wide-area networks, phone systems, outside auditing firms, and management styles were going to come together for the benefit of our customers and employees would have been inappropriate and a true disservice to our customers and employees. I do not consider the discussion of how the two accounting systems, whether before or after the actual merger, to be merger-related costs as such cost were discussed and argued in the merger case. Such costs had nothing to do with investment bankers, Hart, Scott, Rodino filings, severance costs, closing the Portland office or the regulatory approval process; it was simply good management and planning for the two organizations to come together. Many of the costs listed on Schedule 3.03, page 4 of 7 relate to discussions or actions necessary to maintain day to day business functions. Additionally, the KPMG audit fees disallowed on Schedule 3.03, page 5 of 7 were not related to the actual merger. After the merger the combined companies needed only one auditing firm, to have two would not have been cost effective. Accounting and auditing firms are always working in the past, that is the nature of the business. Therefore, while the scope did in fact relate to the past, the actual services were applicable to the present and clearly subsequent to the March merger. The KPMG audit bills that were reviewed by Mr. Luth were dated in June of 1999, well after the actual merger date. The fact that they were reviewing 1998 pension plans and financial statements is not relevant, because if KPMG did not conduct the review then CWC's old audit firm Arthur Andersen LLP would have had to conduct the review. The point is that the costs associated with the review of 1998 and the quarter ended March 31, 1999 were necessary and required from the standpoint of SEC regulations and the Company's bond indentures. Since KPMG was the audit firm for both companies after the merger, they were the proper firm to conduct the review. Audits protect not only the shareholders, but the customers and employees of the company as well.

Q. Do you have any other problems with the portion of Mr. Luth's Service Company Billing Adjustment related to Merger Costs?

A. Yes, this portion of his adjustment relies on the same methodology as does the portion related to lobbying. The Service and Sundry Billings which Mr. Luth labels as merger-related produce a factor which is then applies to the test year, 2001. Thus, even if one agrees for purposes of argument with the merger charges which Mr. Luth has proposed be disallowed, it is not plausible to apply the factor derived from these charges to the test-year, 2001.

As a result of this portion of his adjustment, Mr. Luth is assuming that in 2001, the same percentage of Service Company Billings and Sundry Charges applicable to merger related activity will be billed to the Company as occurred in 1999. The assumption that the same level of merger related activity will occur two years after a merger has closed as occurred in the first twelve months after it closed is not based on fact and should not be accepted as the basis for an adjustment.

Q. **Would you like to comment on Mr. Luths' statement on page 11 and 12, lines 216 through 223 of ICC Staff Exhibit 3.00?**

A. Yes I would. Mr. Luth implies that the reduction in Service Company Billings to CIWC in the year 2000 as compared to 1999 is similar to the Company's inclusion in the 2001 test year of PSC Rate Case Expenses projected to occur in 2000. Mr Luth has taken a period of time which includes Service Company Charges related to two non-recurring events, the merger and the infrastructure replacement legislation ad treated it as the norm by adjusting 2001.

<u>Recommendation #2- Continuing Property Records Internal Audit</u>

Q. **Ms. Hathhorn on page 19 of her testimony has recommended that the Company conduct an internal audit of its continuing property records and asset retirement system, do you agree?**

A. Yes. The Company will comply with Ms. Hathhorn's recommendation.

<u>Recommendation #3- Allocation of Corporate Assets</u>

Q. **Ms. Hathhorn on page 20 of her testimony has recommended that the Company establish separate corporate accounts for the Kankakee Corporate Office and Vermilion Remittance Center, do you agree?**

A. Yes. The Company is in agreement with Ms. Hathhorn's recommendation.

Q. **Does this conclude your Rebuttal testimony?**

A. Yes it does.

SCHEDULE 6.01-R

CONSUMERS ILLINOIS WATER COMPANY
CAPITAL STRUCTURE AS OF DECEMBER 31, 2000 AND PRO FORMA DECEMBER 31, 2001

	Balance As of December 31, 2000	2001 PROJECTED ADJUSTMENTS	12/31/2001 PRO FORMA BALANCE	CAPITALIZATION RATIOS ACTUAL 12/31/2000	CAPITALIZATION RATIOS PRO FORMA 12/31/2001
FIRST MORTGAGE BONDS					
Series M - 10 2/5% - Due 2018	$6,000,000		$6,000,000	6.76%	6.72%
Series N - 9.69% - Due 2021	4,500,000		4,500,000	5.07%	5.04%
Series O - 7.63% - Due 2025	8,000,000		8,000,000	9.02%	8.96%
Series P - 9.19% - Due 2022	6,000,000		6,000,000	6.76%	6.72%
Series Q - 6.10% - Due 2025	10,000,000		10,000,000	11.27%	11.20%
Series R - 6.00% - Due 2025	2,800,000		2,800,000	3.16%	3.13%
Series S - 6.00% - Due 2030	4,500,000		4,500,000	5.07%	5.04%
Subtotal	$41,800,000	$0	$41,800,000	47.11%	46.80%
OTHER LONG TERM DEBT					
Non Interest Bearing - City of Danville	$70,377	($20,000)	$50,377	0.08%	0.06%
Total	$41,870,377	($20,000)	$41,850,377	47.19%	46.85%
SHORT TERM DEBT					
Lines of Credit	$2,000,000		$2,000,000	2.25%	2.24%
PREFERRED EQUITY					
Preferred Stock	$400,000		$400,000	0.45%	0.45%
Premium on Preferred Stock	1,150		1,150	0.00%	0.00%
Total	$401,150		$401,150	0.45%	0.45%
COMMON EQUITY					
Common Shares Issued	$5,983,600		$5,983,600	6.74%	6.70%
Premium on Common Shares	8,966,400		8,966,400	10.11%	10.04%
Other Paid In Capital	13,812,621		13,812,621	15.57%	15.46%
Retained Earnings	15,742,143	614,379	16,356,521	17.74%	18.31%
Capital Stock Expense	(50,792)		(50,792)	-0.06%	-0.06%
Total	$44,453,972	$614,379	$45,068,350	50.10%	50.46%
TOTAL CAPITALIZATION	$88,725,499	$594,379	$89,319,877	100.00%	100.00%

(1) See Detail on Exhibit 2.

SCHEDULE 6.02-R

CONSUMERS ILLINOIS WATER COMPANY
CAPITAL STRUCTURE AS OF DECEMBER 31, 2000 AND PRO FORMA DECEMBER 31, 2001

	Balance As of December 31, 2000	2001 PROJECTED ADJUSTMENTS	12/31/2001 PRO FORMA BALANCE	CAPITALIZATION RATIOS ACTUAL 12/31/2000	CAPITALIZATION RATIOS PRO FORMA 12/31/2001
FIRST MORTGAGE BONDS					
Series M - 10 2/5% - Due 2018	$6,000,000		$6,000,000	6.76%	6.72%
Series N - 9.69% - Due 2021	4,500,000		4,500,000	5.07%	5.04%
Series O - 7.63% - Due 2025	8,000,000		8,000,000	9.02%	8.96%
Series P - 9.19% - Due 2022	6,000,000		6,000,000	6.76%	6.72%
Series Q - 6.10% - Due 2025	10,000,000		10,000,000	11.27%	11.20%
Series R - 6.00% - Due 2025	2,800,000		2,800,000	3.16%	3.13%
Series S - 5.40% - Due 2030	4,500,000		4,500,000	5.07%	5.04%
Subtotal	$41,800,000	$0	$41,800,000	47.11%	46.80%
OTHER LONG TERM DEBT					
Non Interest Bearing - City of Danville	$70,377	($20,000)	$50,377	0.08%	0.06%
Total	$41,870,377	($20,000)	$41,850,377	47.19%	46.85%
SHORT TERM DEBT					
Lines of Credit	$2,000,000		$2,000,000	2.25%	2.24%
PREFERRED EQUITY					
Preferred Stock	$400,000		$400,000	0.45%	0.45%
Premium on Preferred Stock	1,150		1,150	0.00%	0.00%
Total	$401,150		$401,150	0.45%	0.45%
COMMON EQUITY					
Common Shares Issued	$5,983,600		$5,983,600	6.74%	6.70%
Premium on Common Shares	8,966,400		8,966,400	10.11%	10.04%
Other Paid In Capital	13,812,621		13,812,621	15.57%	15.46%
Retained Earnings	15,742,143	614,379	16,356,521	17.74%	18.31%
Capital Stock Expense	(50,792)		(50,792)	-0.06%	-0.06%
Total	$44,453,972	$614,379	$45,068,350	50.10%	50.46%
TOTAL CAPITALIZATION	$88,725,499	$594,379	$89,319,877	100.00%	100.00%

(1) See Detail on Exhibit 2.

ML-3

GROSS UTILITY PLANT AS OF 12/31/00, PER D-9, PAGE 1 of 2 -	$145,899,000
GROSS UTILITY PLANT AS OF 12/31/01, PER D-9, PAGE 1 of 2 -	$149,890,000
AVERAGE	$147,894,500
TOTAL DEFERRED INCOME TAXES AS OF 12/31/00, PER B-9, PAGE 4 of 4:	$8,182,598
TOTAL DEFERRED INCOME TAXES AS OF 12/31/01, PER B-9, PAGE 4 of 4:	$8,527,807
AVERAGE	$8,355,203

VERMILION REMITTANCE CENTER DEPRECIABLE PLANT (B-5, PAGE 3 of 3):

		12/31/00	12/31/01	AVERAGE
304.62	Structures & Improvements	528,099	525,918	527,009
340.62	Office Equipment	275,971	300,487	288,229
340.621	Data Processing Equipment	368,205	366,333	367,269
	Total Depreciable Plant	1,172,275	1,192,738	1,182,507
	Percentage of Gross Utility Plant Above			0.7889%
	Percentage of Gross Utility Plant Times Total Deferred Income Taxes			$64,554

CORPORATE OFFICE - KANKAKEE DIVISION DEPRECIABLE PLANT (B-5, PAGE 3 of 3):

		12/31/00	12/31/01	AVERAGE
304.60	Structures & Improvements	1,648,648	1,661,810	1,655,229
340.60	Office Equipment	2,116,590	2,551,734	2,334,162
341.00	Data Processing Equipment	19,266	19,147	19,207
	Total Depreciable Plant	3,784,504	4,232,691	4,008,598
	Percentage of Gross Utility Plant Above			2.6744%
	Percentage of Gross Utility Plant Times Total Deferred Income Taxes			$218,832

35. Regarding Staff Exhibit 3.00, Schedule 3.03, Page 7 of 7, please provide the calculations supporting the "lobbying employee" percentages of .09504 and .11900 of Services and Sundry billings, respectively.

RESPONSE:

These two percentages were based upon the incorrect totals discussed in Consumers data request 34. The percentages should have been .05223 of payroll billings and .09026 of sundry billings.

The Percentage of Lobbying Employee Payroll to Illinois (page 4 of Schedule 3.03) was determined by dividing the Schedule 3.03 page 7 Services column ($10,764.24) divided by the sum of the page 6 PSC and PSW Payroll columns, excluding June 1999 because there was no detail provided for that month's PSW payroll billing ($206,103.32).

The Sundry Lobbying employee billings to Illinois (page 5 of Schedule 3.03) was determined by dividing the Schedule 3.03 page 7 Sundries column ($17,295.37) divided by the sum of the page 6 PSC and PSW Sundry columns ($191,615.65). Staff witness Luth will correct the totals in rebuttal testimony.

Consumers Illinois Water Company
Reorganization Costs of Merger

SCHEDULE
6.05R

Transaction Costs				
Investment Bankers				
	Smith Barney	Fees		$ 1,300,000
		Expenses		75,000
	Barr Devlin	Fees		2,600,000
		Expenses		75,000
Legal				
	Merger Related	Fees		400,000
Accounting		Fees		125,000
Hart, Scott, Rodino Filing				67,500
				$ 4,642,500
System Integration Costs				
Legal				
	State Regulatory Approvals			$ 500,000
Severance	Corporate Officers			2,174,200
	Corporate Staff			130,100
Retention Bonuses & Consulting Agreements				552,000
Travel & Related Costs				80,000
Close Portland Office				578,350
				$ 4,014,650
Tax Benefit				(954,200)
				$ 3,060,450
Total Reorganization Costs				$ 7,702,950
Total Customers After Merger			523,000	
Total Consumers Illinois Customers			60,076	
Consumers Illinois Portion of Merger Costs				$ 884,823